

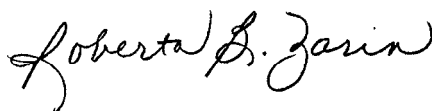
PREFACE

Exempt Organizations (EO) is dedicated to fulfilling the IRS mission to help all customers understand and meet their tax responsibilities. Customer Education & Outreach (CE&O) works closely with Exempt Organizations staff to accomplish this by:

- Developing tailored education programs for customer sub-segments,
- Coordinating the development, revision and design of forms, publications and other non-speaker outreach activities,
- Making standardized educational materials available for outreach efforts, and
- Establishing a means for customers to be heard.

This workshop and our materials are part of a tailored program for representatives of small and mid-sized exempt organizations. We hope that this text helps you become more familiar with tax laws governing exempt organizations and understand how compliance with these laws will strengthen your organization.

The material in this book is for educational use only and may not be cited as precedent.

A handwritten signature in black ink, reading "Roberta L. Zarin". The signature is fluid and cursive, with the first name "Roberta" and last name "Zarin" clearly legible, and "L." as a small initial.

Roberta "Bobby" Zarin
Director, Customer Education and
Outreach, Exempt Organizations

Exempt Organizations Workshop

Objective	Upon completion of this text you will know what an organization exempt under section 501(c) of the Internal Revenue Code must do to avoid activities that can jeopardize an organization's 501(c)(3) status.
Please Note	The material in this text is for educational use only in association with the Exempt Organizations Workshop. It is not intended to establish Internal Revenue Service positions and may <u>not</u> be relied upon or cited as precedent.
For More Information	This text primarily focuses on requirements for 501(c)(3) organizations. Some basic information is presented about organizations exempt under other code sections as well. For a more detailed discussion, including exceptions to the general information provided in this text, please refer to the publications and sections of law cited in the material. Each chapter of this text contains a complete list of references.
Legal Authority	<p>The Internal Revenue Code appears as Title 26 of the United States Code. Congress originally enacted the Internal Revenue Code on August 16, 1954, as the Internal Revenue Code of 1954. It was comprehensively updated when Congress passed the Internal Revenue Act of 1986 on October 22, 1986. Both of these original laws have been amended numerous times by Congress. The resulting body of law guides all tax administration in the United States.</p> <p>The IRS issues regulations that set forth its interpretation of the law. The regulations are issued over the signature of the Secretary of the Treasury (or his delegate) under Title 26 of the Code of Federal Regulations. The regulations carry more weight than any rulings or releases on tax matters otherwise issued by IRS or the Treasury.</p>
Internal Revenue Code (IRC) Citations	All references are to the Internal Revenue Code (IRC) unless otherwise stated. For example, “section 501(c)(3)” refers to Internal Revenue Code section 501(c)(3). The Internal Revenue Code is also sometimes referred to as simply “the Code”.

CHAPTER 3

JEOPARDIZING 501(c)(3) STATUS

**Jeopardizing
Tax-Exempt
Status**

A 501(c)(3) organization must engage primarily in activities that accomplish exempt purposes; an organization that does not do so jeopardizes its tax-exempt status and its eligibility to receive tax-deductible contributions.

Section 501(c)(3) organizations may not be used for the private benefit of any individual, nor may their earnings inure to the benefit of insiders. Moreover, a 501(c)(3) organization may only engage in legislative activities to a limited extent, and is forbidden to engage in political activities. An organization will also lose its exempt status under section 501(c)(3) if it operates for the primary purpose of carrying on an unrelated trade or business, which will be discussed in detail in Chapter 4.

Finally, an organization must meet its reporting obligations by filing Form 990, 990-EZ, or 990-N annually. Failure to comply could result in loss of exempt status. See Chapter 8 for detailed information on this requirement.

Private Benefit

An organization does not qualify for exemption under section 501(c)(3) unless it serves a public rather than a private interest. If the organization engages in an activity that serves both public and private interests, any private benefit must be incidental to the public benefit.

JEOPARDIZING 501(c)(3) STATUS, Continued

Inurement

Section 501(c)(3) of the Code states that no part of an organization's net earnings may inure to the benefit of a private shareholder or individual. This means that a 501(c)(3) organization is prohibited from permitting the use, or making a distribution, of its assets other than as reasonable compensation for goods or services actually furnished or in arm's length transactions.

Inurement generally refers to benefits conferred upon insiders such as officers, directors, and key employees. Examples of prohibited inurement include the payment of dividends or unreasonable compensation and the transfer of property for less than fair market value.

The prohibition against inurement to insiders is absolute; therefore, any amount of inurement is grounds for loss of tax-exempt status. In addition, the insider involved may be subject to excise tax. Note that prohibited inurement does not include reasonable payments for services rendered, payments that further tax-exempt purposes, or payments made for the fair market value of real or personal property.

All inurement is private benefit, but all private benefit is not inurement.

Inurement: Excess Benefit Transactions

The IRS may impose an excise tax on a disqualified person who benefits from an excess benefit transaction as well as any organization manager who knowingly participates in such transaction. An excess benefit transaction is any transaction between a section 501(c)(3) or (4) exempt organization and a disqualified person in which the disqualified person receives an economic benefit greater than the value of the consideration provided for the benefit (such as a non-fair market value transaction or unreasonable compensation for services).

A disqualified person is any person who is, or was, in a position to exercise substantial influence over the affairs of the organization.

JEOPARDIZING 501(c)(3) STATUS, Continued

Preventing Private Benefit and Inurement: Internal Controls

Adopting and implementing internal controls may help exempt organizations prevent private benefit and inurement, and thus help protect an organization's tax-exempt status. An internal control system may include some or all of the following elements:

- Segregating financial duties
 - Requiring second signatures on large checks
 - Tracking inventory
 - Conducting internal audits (i.e., formal review of an organization's activities to ensure that proper policies are in place to implement internal controls)
 - Recordkeeping (see Chapter 7)
-

Preventing Private Benefit and Inurement: Conflict of Interest Policy

Adopting a conflict of interest policy may also help prevent inurement. A conflict of interest policy may include the following elements:

- Procedures for disclosure by persons having a financial interest
- Procedures for determining whether the financial interest of a person may result in a conflict of interest
- Procedures for addressing the conflict of interest after determining that there is a conflict
- Procedures for adequate recordkeeping of actions taken
- Procedures ensuring that the policy is distributed to all trustees, principal officers, and other persons in authority

An example of a Conflict of Interest Policy can be found at the end of this chapter in Exhibit C.

Lobbying and Political Activities

A section 501(c)(3) organization may conduct only a limited amount of lobbying activity and is prohibited from intervening in any political campaign activities.

JEOPARDIZING 501(c)(3) STATUS, Continued

Lobbying Activity

A 501(c)(3) organization may conduct lobbying activities as long as they are insubstantial in relation to their exempt purpose activities. Lobbying is defined as an attempt by an exempt organization to influence legislation.

Legislation includes action by Congress, any state legislature, any local council, or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative confirmation of appointive office), or by the public in referendum, ballot initiative, constitutional amendment, or similar procedure. It does not include actions by executive, judicial, or administrative bodies.

An organization is considered to be attempting to influence legislation if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if the organization advocates the adoption or rejection of legislation.

Organizations may, however, engage public policy issues without the activity being considered as lobbying. For example, organizations may conduct educational meetings, prepare and distribute educational materials, or otherwise consider public policy issues in an educational manner without jeopardizing their tax-exempt status.

If lobbying activities are substantial, a 501(c)(3) organization may fail the operational test and risks losing its tax-exempt status. Substantiality is measured by one of the following two tests:

- The substantial part test
 - or
 - The expenditure test
-

JEOPARDIZING 501(c)(3) STATUS, Continued

Measuring Lobbying Activity: Substantial Part Test

The substantial part test determines substantiality on the basis of all the pertinent facts and circumstances in each case. The IRS considers a variety of factors, including the time devoted (by both compensated and volunteer workers) and the expenditures devoted by the organization to the activity, when determining whether the lobbying activity is substantial.

Under the substantial part test, an organization that conducts excessive lobbying activity in any taxable year may lose its tax-exempt status, resulting in all of its income being subject to tax. In addition, an organization is subject to an excise tax equal to 5 percent of its lobbying expenditures for the year in which it ceases to qualify for exemption.

Further, a tax equal to 5 percent of the lobbying expenditures for the year may be imposed against organization managers, jointly and severally, who facilitated or agreed to such expenditures with the knowledge that the expenditures would likely result in the loss of tax-exempt status.

Measuring Lobbying Activity: Expenditure Test

As an alternative to the subjective substantial part test, most public charities may elect to use the expenditure test under section 501(h), which is an objective, mathematical test. Sections 501(h) and 4911 of the Code establish a sliding scale of permissible “lobbying nontaxable amounts.” Expenditures in excess of the nontaxable amount are called excess lobbying expenditures and are subject to a 25 percent excise tax. In addition, an organization will lose its exemption if it “normally” spends more than 150 percent of its lobbying nontaxable amount over a 4-year period.

JEOPARDIZING 501(c)(3) STATUS, Continued

**Measuring
Lobbying
Activity:
Expenditure
Test Measuring
Lobbying
Activity:
Expenditure
Test (continued)**

Churches and church-related organizations, including integrated auxiliaries and conventions or associations of churches and affiliates of these organizations, may not elect to use the expenditure test.

Organizations electing to use the expenditure test must file Form 5768, *Election/Revocation of Election by an Eligible IRC Section 501(c)(3) Organization to Make Expenditures to Influence Legislation*, at any time during the tax year for which it is to be effective. The election remains in effect for succeeding years unless it is revoked by the organization. Revocation of the election is effective on the year following the year in which the revocation is filed.

**Political
Campaign
Activity**

Section 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the organization in favor of or in opposition to any candidate for public office clearly violate the prohibition against political campaign activity. Violation of this prohibition may result in denial or revocation of tax-exempt status and the imposition of an excise tax on the amount of the political expenditure.

For example, voter education or registration activities with evidence of bias that: (a) would favor one candidate over another; (b) oppose a candidate in some manner; or (c) have the effect of favoring a candidate or group of candidates, would constitute prohibited participation or intervention.

Depending on the facts and circumstances, certain activities or expenditures may not be prohibited. For example, certain voter education activities, including the presentation of public forums and the publication of voter education guides, conducted in a nonpartisan manner do not constitute prohibited political campaign activity.

In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and get-out-the-vote drives, would not constitute prohibited political campaign activity if conducted in a nonpartisan manner.

JEOPARDIZING 501(c)(3) STATUS, Continued

Individual Activity by Organization Leaders

The political campaign activity prohibition is not intended to restrict free expression on political matters by leaders of organizations speaking for themselves in their private capacity as individuals. Nor are they prohibited from speaking about important issues of public policy. However, for their organizations to remain tax exempt under section 501(c)(3), leaders cannot make partisan comments in official organization publications or at official functions.

To avoid potential attribution of their comments outside of organization functions and publications, organization leaders who speak or write in their individual capacity are encouraged to clearly indicate that their comments are personal and not intended to represent the views of the organization.

Inviting a Candidate to Speak

Depending on the facts and circumstances, an organization may invite political candidates to speak at its events without jeopardizing its tax-exempt status. Political candidates may be invited in their capacity as candidates, or individually (not as a candidate).

Speaking as a Candidate: When a candidate is invited to speak at an organization event as a political candidate, the organization must take steps to ensure that:

- It provides an equal opportunity to political candidates seeking the same office,
- It does not indicate any support of or opposition to the candidate (This should be stated explicitly when the candidate is introduced and in communications concerning the candidate's attendance.), and
- No political fundraising occurs.

Equal Opportunity to Participate: In determining whether candidates are given an equal opportunity to participate, an organization should consider the nature of the event to which each candidate is invited, in addition to the manner of presentation.

For example, an organization that invites one candidate to speak at its well-attended annual banquet, but invites the opposing candidate to speak at a sparsely attended general meeting, will likely be found to have violated the political campaign prohibition, even if the manner of presentation for both speakers is otherwise neutral.

JEOPARDIZING 501(c)(3) STATUS, Continued

Inviting a Candidate to Speak (continued)

Public Forum: Sometimes an organization invites several candidates to speak at a public forum. A public forum involving several candidates for public office may qualify as an exempt educational activity. However, if the forum is operated to show a bias for or against any candidate, then the forum would be a prohibited campaign activity, as it would be considered intervention or participation in a political campaign.

When an organization invites several candidates to speak at a forum, it should consider the following factors:

- Whether questions for the candidates are prepared and presented by an independent nonpartisan panel,
- Whether the topics discussed by the candidates cover a broad range of issues that the candidates would address if elected to the office sought and are of interest to the public,
- Whether each candidate is given an equal opportunity to present his or her views on the issues discussed,
- Whether the candidates are asked to agree or disagree with positions, agendas, platforms, or statements of the organization, and
- Whether a moderator comments on the questions or otherwise implies approval or disapproval of the candidates.

Speaking as a Non-Candidate: An organization may invite political candidates to speak in a non-candidate capacity. For instance, a political candidate may be a public figure because he or she:

- Currently holds, or formerly held, public office,
- Is considered an expert in a non-political field, or
- Is a celebrity or has led a distinguished military, legal, or public service career.

When a candidate is invited to speak at an event in a non-candidate capacity, it is not necessary for the organization to provide equal access to all political candidates.

JEOPARDIZING 501(c)(3) STATUS, Continued

Inviting a Candidate to Speak (continued)

However, the organization must ensure that:

- The individual is chosen to speak solely for reasons other than candidacy for public office,
- The individual speaks only in a non-candidate capacity,
- Neither the individual nor any representative of the organization makes any mention of the individual's candidacy or the election,
- The event is held in a nonpartisan atmosphere, and
- No campaign activity occurs in connection with the candidate's attendance.

In addition, the organization should clearly indicate the capacity in which the candidate is appearing and should not mention the individual's political candidacy or the upcoming election in the communications announcing the candidate's attendance at the event.

JEOPARDIZING 501(c)(3) STATUS, Continued

Voter Guides

Some organizations distribute voter guides as part of their voter education activities. Voter guides are usually distributed during an election campaign and provide information on how candidates stand on various issues.

A careful review of the following facts and circumstances may help determine whether or not an organization's publication or distribution of voter guides constitutes prohibited political campaign activity:

- Whether the candidates' positions are compared to the organization's position
- Whether the guide includes a broad range of issues that the candidates would address if elected to the office sought
- Whether the description of issues is neutral
- Whether all candidates for an office are included
- Whether the descriptions of candidates' positions are either:
 - The candidates' own words in response to questions, or
 - A neutral, unbiased, and complete compilation of all candidates' positions.

Business Activity

The question of whether an activity constitutes participation or intervention in a political campaign may also arise in the context of a business activity of the organization, such as the selling or renting of mailing lists, the leasing of office space, or the acceptance of paid political advertising. In this context, some of the factors to be considered in determining whether the organization has engaged in prohibited political campaign activity include the following:

- Whether the good, service, or facility is available to the candidates on an equal basis
 - Whether the good, service, or facility is available only to candidates and not to the general public
 - Whether the fees charged to candidates are at the organization's customary and usual rates
 - Whether the activity is an ongoing activity of the organization or whether it is conducted only for the candidate
-

JEOPARDIZING 501(c)(3) STATUS, Continued

Consequences of Political Campaign Activity

In addition to risking loss of tax-exempt status under section 501(c)(3) and eligibility to receive tax-deductible contributions, an organization that engages in political campaign activity may become subject to an excise tax on its political expenditures. A political expenditure is any amount paid or debt incurred while participating or intervening in any political campaign. This excise tax may be imposed in addition to, or in lieu of, revocation of exempt status. The organization must correct the violation to avoid additional taxes.

Excise Tax

An initial tax is imposed on an organization at the rate of 10 percent of the political expenditures. Also, a tax at the rate of 2.5 percent of the expenditures is imposed against the organization managers (jointly and severally) who, without reasonable cause, agreed to the expenditures knowing they were political expenditures. The tax on management may not exceed \$5,000 with respect to any one expenditure.

In any case in which an initial tax is imposed against an organization, and the expenditure is not corrected within the period allowed by law, an additional tax equal to 100 percent of the expenditures is imposed against the organization. In that case, an additional tax is also imposed against the organization managers (jointly and severally) who refused to agree to make the correction. The additional tax on management is equal to 50 percent of the expenditures and may not exceed \$10,000 with respect to any one expenditure.

Correction of Expenditure

Correction of a political expenditure requires the recovery of the expenditure, to the extent possible, and establishment of safeguards to prevent future political expenditures.

JEOPARDIZING 501(c)(3) STATUS, Continued

Failure to Comply with Reporting Obligations

While 501(c)(3)s are exempt from federal income tax and unemployment tax, most of them will have information reporting obligations. These are met by filing Form 990, 990-EZ, or 990-N. For the particulars on exactly which organizations must file, which form to use, and how to complete it, see Chapter 8.

Failure to file Form 990, Form 990-EZ, or Form 990-N can jeopardize an organization's tax-exempt status. If an organization does not file for 3 consecutive years, its tax-exempt status will be revoked as of the filing due date for the third return. If tax-exempt status is revoked on this basis, the organization must apply (or reapply) by filing Form 1023 (or Form 1024 for exemption under subsections other than 501(c)(3)) and pay the appropriate user fee to have its tax-exempt status reinstated. If it can show reasonable cause for not filing, the reinstatement of tax-exempt status may be retroactive.

For More Information

Publication 557, *Tax-Exempt Status for Your Organization*

Publication 1828, *Tax Guide for Churches and Religious Organizations*

Publication 4221, *Compliance Guide for 501(c)(3) Tax-Exempt Organizations*

Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*

The Conflict of Interest article in Exhibit C, which can also be found at:
<http://www.irs.gov/pub/irs-tege/eotopice00.pdf>

Forms and Publications

You may order Forms and Publications by calling (800) 829-3676 or by downloading them from www.irs.gov/.

Jeopardizing Section 501(c)(3) Status - Case Studies

Case Study 1

Jane Doe is founder and President of XYZ Charity, a 501(c)(3) organization. XYZ's bylaws specify that the President is a voting member of the seven-person Board of Directors. Jane also owns 49% of M Corporation, a for-profit, advertising company run by her husband, Jim, who owns the other 51% percent. XYZ Charity signed a \$200,000 contract with M Corporation to coordinate the advertising campaign for the charity's annual appeal. Jane signed this contract on behalf of XYZ Charity, without bringing it to the entire Board of Directors for discussion and action. Since Jim knows that there will be no competitive bidding for the contract, he decides to bill at a rate of about 120% of the fair market value of the work. He calls the contract the "M Company Deluxe Package," but in reality the services provided are the same as M Company provides to any other customer.

1. Does this scenario show private benefit or inurement? Why?
2. If there is private benefit or inurement, what could the organization have done to prevent it?

Case Study 2

DEF Hospital is a tax-exempt hospital with 250 beds, a busy emergency room, and a full range of medical and surgical specialties. Bob is the CEO of the hospital. Bob is paid annual compensation of \$300,000. His compensation was determined by the compensation committee of the hospital's board of directors. Bob is not a member of this committee. His salary is comparable to the salaries paid to CEOs of other similar-sized health-care organizations. In addition to his salary, Bob's compensation agreement with the hospital requires that Bob be provided with the use of a BMW for both business and personal use. His personal use of the car is carefully documented and is included as compensation on his Form W-2. Over the past few years, the cost of his personal use of the car has averaged about \$11,000 per year.

1. Does this scenario show private benefit or inurement? Why?
2. If there is private benefit or inurement, what could the organization have done to prevent it?

Jeopardizing Section 501(c)(3) Status - Case Studies, Continued

Case Study 3 (Work both scenarios; arrive at separate conclusions for each one.)

Scenario A – Individual Activity by an Organization’s Leader

President B is the president of University K, a section 501(c)(3) organization. University K publishes a monthly alumni newsletter that is distributed to all alumni of the university. In each issue, President B has a column titled “My Views.” The month before the election, President B states in the “My Views” column, “It is my personal opinion that Candidate U should be reelected.” For that one issue, President B pays from his personal funds the portion of the cost of the newsletter attributable to the “My Views” column.

Question: What factors should be considered in determining whether or not the prohibition against political intervention has been violated?

After considering these factors, do you think President B’s actions constitute political campaign intervention attributable to University K?

Why or why not?

Scenario B – Candidate Appearances

President E is the president of Society N, a historical society that is a section 501(c)(3) organization. In the month prior to an election, President E invites the four Congressional candidates for the district in which Society N is located to address the members, one each at a regular meeting held on successive weeks. Each candidate is given an equal opportunity to address and field questions on a wide variety of topics from the members. One of the candidates declines the invitation. Society N’s publicity announces the dates for each of the candidate’s speeches, states that the order of the speakers was determined at random, and indicates that one invited candidate has declined. President E’s introduction of each candidate include no comments on their qualifications or any indication of a preference for any candidate.

Question: What factors should be considered in determining whether or not the prohibition against political intervention has been violated?

After considering these factors, do you think Society E has engaged in political activity by inviting the speakers?

Why or why not?

Has President E engaged in political activity attributable to Society N?

Why or why not?

TAX-EXEMPT HEALTH CARE ORGANIZATIONS REVISED CONFLICTS OF INTEREST POLICY

by

Lawrence M. Brauer and Charles F. Kaiser III

1. Introduction

The 1997 CPE Text discussed a community board and conflicts of interest policy as factors the Service takes into consideration in determining whether hospitals and other health care organizations satisfy the community benefit standard in Rev. Rul. 69-545, 1969-2 C.B. 117. One significant fact demonstrating that a tax-exempt health care organization promotes the health of the community as a whole, rather than benefiting private interests, is the organization's adoption of a substantial conflicts of interest policy. The 1997 CPE Text included a sample conflicts of interest policy that can be adopted in an organization's bylaws or through resolution by its board of directors.

Based on comments we received from the interested community, the sample policy has been modified in several respects, as explained below. The revised sample policy is also attached to this article.

2. Article II, Definitions

A. Section 2, Financial Interest

The sample policy was revised to clarify that a person having a financial interest does not necessarily have a conflict of interest. The board of directors or the appropriate board committee has the responsibility to determine, based on all the facts and circumstances, whether the financial interest of an interested person rises to the level of a conflict of interest. Thus, the following new sentence was added:

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate board or committee decides that a conflict of interest exists.

3. Article III, Procedures

Several clarifications were made to the Procedures part of the sample policy.

A. Section 1, Duty to Disclose

Before the board or committee makes a determination whether the financial interest of an interested person rises to the level of a conflict of interest, the interested person must be given the opportunity to disclose all material facts relating to his/her financial interest.

B. Section 2, Determining Whether A Conflict of Interest Exists

If the interested person discloses all material facts relating to his/her financial interest, the board or committee can continue to discuss the issue with the interested person to clarify or obtain additional information relevant to the financial interest. However, before the board or committee discusses and votes on whether the interested person's financial interest is a conflict of interest, the interested person must leave the meeting.

C. Section 3(a), Procedures for Addressing the Conflict of Interest

An interested person with a conflict of interest in a transaction or arrangement is not precluded from making a presentation to the board or committee regarding the transaction or arrangement. However, before the board or committee discusses and votes on the transaction or arrangement, the interested person must leave the meeting.

4. Article V, Compensation

The Compensation part of the sample policy was also modified to clarify several items.

A. Section 1

A new paragraph was added providing that an individual who is a voting member of the board of directors and receives compensation from the corporation for services may not vote on any matter pertaining to that member's compensation.

B. Section 2

Another new paragraph was added stating that a physician who is a voting member of the board of directors and receives compensation, directly or indirectly, from the Corporation for services is precluded from discussing and voting on matters pertaining to that member's and other physicians' compensation. In addition, the sample policy provides that no physician or physician director, either individually or collectively, is prohibited from providing information to the board of directors regarding physician compensation.

C. Section 4

A new sentence was added providing that although a physician with a direct or indirect financial interest in a corporation may not be a member of a compensation committee, the physician may provide information to the committee regarding physician compensation in general.

In all other respects, the sample conflicts of interest policy that appeared in the 1997 CPE text remains unchanged.

SAMPLE CONFLICTS OF INTEREST POLICY

(Revised 1999)

Article I

Purpose

The purpose of the conflicts of interest policy is to protect the Corporation's interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of an officer or director of the Corporation. This policy is intended to supplement but not replace any applicable state laws governing conflicts of interest applicable to nonprofit and charitable corporations.

Article II

Definitions

1. Interested Person

Any director, principal officer, or member of a committee with board delegated powers who has a direct or indirect financial interest, as defined below, is an interested person. If a person is an interested person with respect to any entity in the health care system of which the Corporation is a part, he or she is an interested person with respect to all entities in the health care system.

2. Financial Interest

A person has a financial interest if the person has, directly or indirectly, through business, investment or family--

- a. an ownership or investment interest in any entity with which the Corporation has a transaction or arrangement, or
- b. a compensation arrangement with the Corporation or with any entity or individual with which the Corporation has a transaction or arrangement, or
- c. a potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Corporation is negotiating a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are substantial in nature.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate board or committee decides that a conflict of interest exists.

Article III

Procedures

1. Duty to Disclose

In connection with any actual or possible conflicts of interest, an interested person must disclose the existence of his or her financial interest and must be given the opportunity to disclose all material facts to the directors and members of committees with board delegated powers considering the proposed transaction or arrangement.

2. Determining Whether a Conflict of Interest Exists

After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she shall leave the board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

3. Procedures for Addressing the Conflict of Interest

- a. An interested person may make a presentation at the board or committee meeting, but after such presentation, he/she shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement that results in the conflict of interest.
- b. The chairperson of the board or committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
- c. After exercising due diligence, the board or committee shall determine whether the Corporation can obtain a more advantageous transaction or arrangement with reasonable efforts from a person or entity that would not give rise to a conflict of interest.
- d. If a more advantageous transaction or arrangement is not reasonably attainable under circumstances that would not give rise to a conflict of interest, the board or committee shall determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Corporation's best interest and for its own benefit and whether the transaction is fair and reasonable to the Corporation and shall make its decision as to whether to enter into the transaction or arrangement in conformity with such determination.

4. Violations of the Conflicts of Interest Policy

- a. If the board or committee has reasonable cause to believe that a member has failed to disclose actual or possible conflicts of interest, it shall inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.
- b. If, after hearing the response of the member and making such further investigation as may be warranted in the circumstances, the board or committee determines that the member has in fact failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

Article IV

Records of Proceedings

The minutes of the board and all committee with board-delegated powers shall contain--

1. the names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the board's or committee's decision as to whether a conflict of interest in fact existed.
2. the names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection therewith.

Article V

Compensation

1. A voting member of the board of directors who receives compensation, directly or indirectly, from the Corporation for services is precluded from voting on matters pertaining to that member's compensation.
2. A physician who is a voting member of the board of directors and receives compensation, directly or indirectly, from the Corporation for services is precluded from discussing and voting on matters pertaining to that member's and other physicians' compensation. No physician or physician director, either individually or collectively, is prohibited from providing information to the board of directors regarding physician compensation.

3. A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Corporation for services is precluded from voting on matters pertaining to that member's compensation.
4. Physicians who receive compensation, directly or indirectly, from the Corporation, whether as employees or independent contractors, are precluded from membership on any committee whose jurisdiction includes compensation matters. No physician, either individually or collectively, is prohibited from providing information to any committee regarding physician compensation.

Article VI

Annual Statements

Each director, principal officer and member of a committee with board delegated powers shall annually sign a statement which affirms that such person--

- a. has received a copy of the conflicts of interest policy,
- b. has read and understands the policy,
- c. has agreed to comply with the policy, and
- d. understands that the Corporation is a charitable organization and that in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

Article VII

Periodic Reviews

To ensure that the Corporation operates in a manner consistent with its charitable purposes and that it does not engage in activities that could jeopardize its status as an organization exempt from federal income tax, periodic reviews shall be conducted. The periodic reviews shall, at a minimum, include the following subjects:

- a. Whether compensation arrangements and benefits are reasonable and are the result of arm's-length bargaining.

- b. Whether acquisitions of physician practices and other provider services result in inurement or impermissible private benefit.
- c. Whether partnership and joint venture arrangements and arrangements with management service organizations and physician hospital organizations conform to written policies, are properly recorded, reflect reasonable payments for goods and services, further the Corporation's charitable purposes and do not result in inurement or impermissible private benefit.
- d. Whether agreements to provide health care and agreements with other health care providers, employees, and third party payors further the Corporation's charitable purposes and do not result in inurement or impermissible private benefit.

Article VIII

Use of Outside Experts

In conducting the periodic reviews provided for in Article VII, the Corporation may, but need not, use outside advisors. If outside experts are used their use shall not relieve the board of its responsibility for ensuring that periodic reviews are conducted.

CLOSING

Exempt Organizations and the Internal Revenue Service

The goal of the Exempt Organizations office of the IRS is to promote compliance with the tax laws governing exempt organizations. It does this:

- Through outreach and educational efforts
 - By issuing rulings that apply tax laws to an exempt organization's specific set of facts
 - Through examinations and other compliance activities
-

Ways Exempt Organizations Can Get Help from the IRS

The IRS has several ways that officers or representatives of exempt organizations can get help on tax issues:

Customer Account Services: Call (877) 829-5500 (toll free). Ask Exempt Organizations specialists general questions about exempt organizations or questions about a specific organization's account. The caller must have the organization's employer identification number (EIN) handy and know the organization's legal name.

For some account-specific questions, the caller will need to establish his or her right to access the information. He or she must be an authorized officer or a representative of the organization with power-of-attorney rights.

EO Website: Point your browser to www.irs.gov/eo for a wealth of information and "how-to" assistance including:

- Descriptions, rules, and requirements for different types of exempt organizations
 - Life Cycle of an Exempt Organization
 - Published guidance
 - Tips on how to avoid filing errors
-

CLOSING, Continued

More Ways Exempt Organizations Can Get Help from the IRS

Web-based Training. Go to www.stayexempt.irs.gov to participate in a “virtual” workshop or to view on-line “mini-courses” on a variety of EO topics.

Forms and Publications: Call (800) 829-3676 to order free IRS publications and forms or download them from the IRS website at www.irs.gov/.

For More Information

General IRS Questions: (800) 829-1040 (toll-free)

TEGE Customer Service: (877) 829-5500 (toll-free)
(EO questions)

Forms and Publications: (800) 829-3676 (toll-free)

IRS Internet Site: www.irs.gov

EO Page: www.irs.gov/eo

On-line Training: www.stayexempt.irs.org

EO Update: Subscribe to this IRS e-mail service to receive the following related to exempt organizations: news releases, new forms, guidance and other publications, changes and additions to the EO Page on IRS.gov and information about upcoming training and outreach events. Visit www.irs.gov/eo to subscribe.

The IRS Needs YOUR Help

The IRS would like your feedback on our products. Please contact us with your recommendations on changes or additions that would improve your understanding of exempt status requirements.
